



STATE BOARD OF EQUALIZATION

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March 20, 1989

Dear Ms.

This is in response to your February 23, 1989, letter to Mr. Don Conlee of our Orange County Office wherein you requested our views on the assessment/tax consequences of the following situations.

1. A leasing company holding equipment intended for lease in the ordinary course of business leases certain equipment. Thereafter, the lessee defaults, the lease is terminated, and on the March 1 lien date the leasing company is entitled to possession of the equipment which it will again hold for lease in the ordinary course of business. The leasing company may consider the equipment as part of its business inventory eligible for the business inventory exemption (Rev. & Tax. Code, § 219), even though the equipment has not yet been returned and thus, is not in its physical possession on the lien date.

Proceeding from the premise that there is no doubt that the lease has been terminated, we conclude that the equipment would be eligible for the business inventory exemption under the stated circumstances. Revenue and Taxation Code section 129 provides, in part:

"'Business inventories' shall include goods intended for sale or lease in the ordinary course of business and shall include raw materials and work in process with respect to such goods. . . .

"'Business inventories' shall not include any goods actually leased or rented on the lien date nor shall 'business inventories' include business machinery or equipment or office furniture, machines or equipment, except when such property is held for sale or lease in the ordinary course of business. 'Business inventories' shall not include any item held for lease which has been or is intended to be used by the lessor prior to or subsequent to the lease."

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See also Property Tax Rule No. 133, Business Inventory Exemption, in this regard, copy enclosed.

As evidenced by section 129, "business inventories" does not include business equipment, except where such equipment is held for sale or lease in the ordinary course of business, and rule 133 similarly provides that property held for sale or lease in the ordinary course of business is "business inventories", but that property held primarily for use by a lessee or other recipient of the property rather than for lease is not.

In this instance, upon the termination of the lease, the equipment would not be either leased or used on the March 1 lien date. Thus, the leasing company would be holding the equipment for lease in the ordinary course of its business on that date, and the equipment would be eligible for the exemption.

In our view, there is no sound basis for concluding that property while off lease must be removed from the premises of the former lessee and be in the possession of the lessor to be eligible for exemption. Of course, property off lease will, at some point in time, be removed from the premises of the former lessee. Depending upon considerations such as the size of the property, availability of transport, etc., however, such removal may occur immediately upon the termination of the lease, soon thereafter, or at some later date. But either there is a lease in effect on the lien date or there is not. If there is not, a lessor's property could be in numerous locations on the lien date, for example, on the premises of the former lessee awaiting pick-up for shipment, in transit to another for placement under a lease being negotiated, in transit to the lessor pending re-lease, or at the repair facility of another for repair prior to re-lease, but the property could still be held for lease on the lien date.

2. Between the time the lease is terminated and the time the leasing company receives physical possession of the equipment, 1, above, the equipment is assessed as of the March 1 lien date. If there had been a provision in the lease making the (former) lessee responsible for personal property taxes, the (former) lessee would be liable for the taxes. If the leasing company were assessed, however, it could include the equipment in its claim for the business inventory exemption and the equipment would be eligible for the exemption.

In lease situations, county assessors may assess property to the lessor, to the lessee, or to both. Revenue and Taxation Code section 405 states as follows in this regard:

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"(a) Annually, the assessor shall assess all the taxable property in his county . . . to the persons owning, claiming, possessing, or controlling it on the lien date.

"The assessor may assess the property on the secured roll to the person owning, claiming, possessing, or controlling it for the ensuing fiscal year.

"(b) The assessor may assess all taxable property in his county on the unsecured roll jointly to both the lessee and lessor of such property.

"(c) Notices of assessment and tax bills relating to jointly assessed property on the unsecured roll shall be mailed to both the lessee and the lessor at their latest addresses known to the assessor."

Again, assuming that it is clear that the lease has been terminated, when brought to the attention of the county assessor through the filing of the leasing company's business property statement (Rev. & Tax. Code, § 441, et seq.) or otherwise, the county assessor would, no doubt, assess the equipment to the leasing company; and as indicated above, the leasing company could claim the exemption for the equipment if held in the ordinary course of business for lease. If for some reason such termination was not brought to the attention of the county assessor, he or she might assess the equipment pursuant to section 405 to the leasing company, to the (former) lessee, or to both. However, upon any assessment to the (former) lessee under the circumstances, the former lessee would, no doubt, notify the county assessor that the lease had been terminated, that it was not claiming or controlling the equipment, that it had no interest in the equipment, etc., and the county assessor could then consider the applicability of roll correction sections (Rev. & Tax. Code, §§ 4831, et seq.) and cancellation sections (Rev. & Tax. Code, §§ 4985, et seq.). Assuming correction or cancellation, the leasing company would become the sole assessee, either as the result of the initial assessment of the equipment to it and to the former lessee (Rev. & Tax. Code, § 405) or as the result of an escape assessment (Rev. & Tax. Code, §§ 531, et seq.), in the event the former lessee had been the sole assessee.

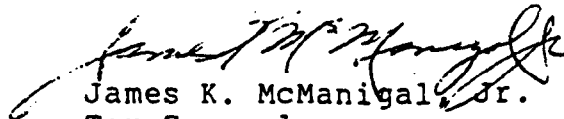
As to any provision in the lease making the (former) lessee responsible for personal property taxes, such would not be binding upon the county assessor, who derives his or her authority to assess from section 405, as indicated, or upon the county tax collector, who similarly derives his or her authority to collect applicable taxes by statute. Rather, such

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a provision would be a matter of contract between the parties, to be resolved among themselves, and would not preclude the tax collector from pursuing the leasing company for any applicable taxes owing as the result of an assessment for the equipment made to the leasing company.

In conclusion, the views expressed herein are advisory only. Since the business inventory exemption is administered by county assessors, you may wish to consult the appropriate county assessor or assessors of the county or counties in which the leasing company has its equipment to confirm that he or she or they are administering the exemption in the manner hereinabove set forth.

Very truly yours,

  
James K. McManigal, Jr.  
Tax Counsel

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2291H

Enclosure

cc: Hon. Bradley Jacobs  
Orange County Assessor  
Mr. Don Conlee  
Mr. John W. Hagerty  
Mr. Robert Gustafson  
Mr. Verne Walton  
Mr. Bruce Dear